



FOCUS ON BUSINESS VALUE
2022 Crowe Financial Services Conference

Financial Institution Hot Topic: Emerging Investments and Activities

November & December 2022

Presented by:

Crowe Industry Specialists

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FinTech and BaaS Market Trends

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FinTech and BaaS Market Trends



FinTech and BaaS Market Trends

- ✓ FinTechs becoming Banks
- ✓ Banks directly investing in FinTechs
- ✓ Banks investing in FinTech funds (i.e., JAM, FINTOP, Canapi Ventures)
- ✓ Banks embedding FinTech
- ✓ Banks providing Banking as a Service to FinTech partners

Unbundling of a Bank



Source: CB Insights

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Key Terms

FinTech

Products and companies that employ newly developed digital and online technologies in the banking and financial services industries.

Banking as a Service (“BaaS”)

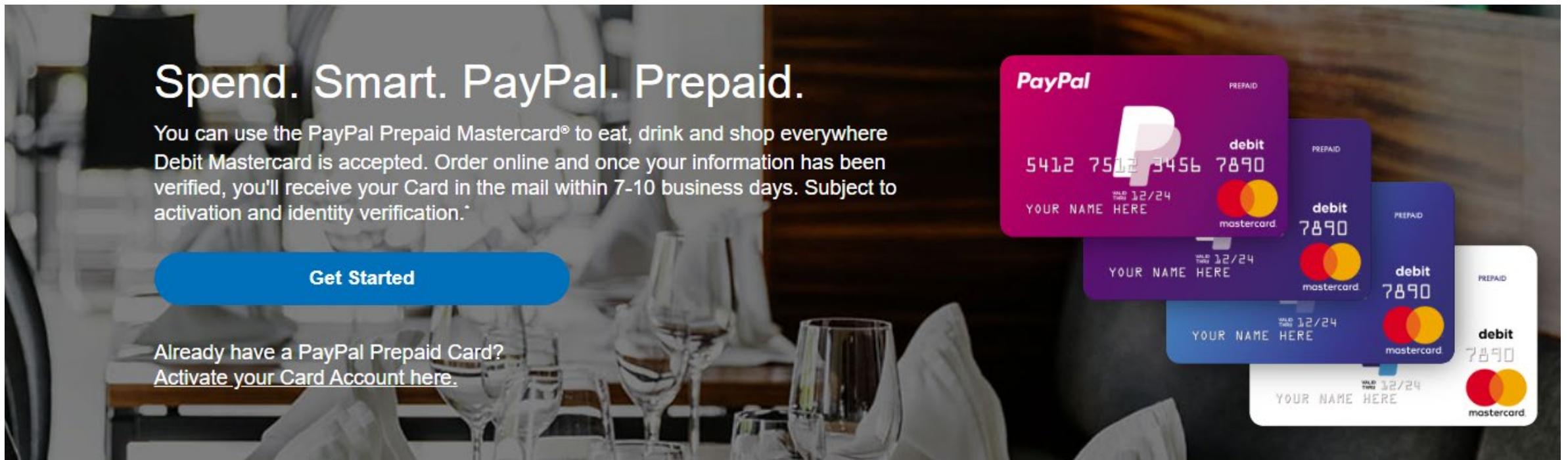
A partnership model in which a financial institution leverages its bank charter to enable one or more non-bank financial services companies to offer products directly to customers.

Bank of Record / Sponsor Bank

Financial institution offering BaaS. Non-financial companies may list their sponsor bank as the “bank of record” on legal disclosures.



Key Terms in Action



Spend. Smart. PayPal. Prepaid.

You can use the PayPal Prepaid Mastercard® to eat, drink and shop everywhere Debit Mastercard is accepted. Order online and once your information has been verified, you'll receive your Card in the mail within 7-10 business days. Subject to activation and identity verification.*

[Get Started](#)

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* The Savings Account is made available to Cardholders through The Bancorp Bank; Member FDIC. To participate in the Savings Account program, Cardholder must consent to and continue receiving communications from us in electronic form. If Cardholder is subject to Internal Revenue Service backup withholding at the time of the request to open a Savings Account, the request will be declined. Interest is calculated on the Average Daily Balance(s) of the Savings Account and is paid quarterly.

BaaS Landscape: Sample of Trends

Market performance of select banking-as-a-service providers

Company (ticker)	As of Oct. 24, 2022				
	Market cap (\$M)	P/TBV (%)	Total return (%)		Dividend yield (%)
			1-year	3-year	
The Bancorp Inc. (TBBK)	1,415.6	217.5	-21.4	146.6	0.00
Pathward Financial Inc. (CASH)	1,112.5	290.1	-37.9	9.5	0.52
Green Dot Corp. (GDOT)	967.5	214.1	-59.4	-26.7	0.00
Metropolitan Bank Holding Corp. (MCB)	674.4	117.8	-35.2	49.6	0.00
Coastal Financial Corp. (CCB)	527.2	242.2	18.1	164.4	0.00
MVB Financial Corp. (MVBF)	317.9	125.8	-39.8	32.5	2.68
First Internet Bancorp (INBK)	222.1	62.8	-32.8	9.9	1.00
Provident Bancorp Inc. (PVBC)	214.3	90.8	-27.4	10.4	1.30
Medallion Financial Corp. (MFIN)	156.5	134.0	-17.3	7.8	4.80
FinWise Bancorp. (FINW)	109.1	83.6	N.A.	N.A.	0.00
Group median	129.9		-32.8	10.4	0.26

Data compiled Oct. 26, 2022.

P/TBV = price-to-tangible book value; N.A. = not available.

Analysis includes select U.S. public financial institutions, which themselves or through their subsidiaries, offer banking-as-a-service products.

Source: S&P Global Market Intelligence.

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Lower than the industry median of 143.6% as of Sept. 30

Financial performance of select banking-as-a-service providers

Company (ticker)	Jun. 30, 2022		12 months ended Jun. 30, 2022		
	total assets (\$B)	YOY change (%)	ROAA (%)	Efficiency ratio (%)	NIM (%)
The Bancorp Inc. (TBBK)	7.12	8.7	1.72	50.30	3.28
Metropolitan Bank Holding Corp. (MCB)	6.87	18.7	1.28	44.35	3.14
Pathward Financial Inc. (CASH)	6.73	-4.6	2.10	63.09	4.63
Green Dot Corp. (GDOT)	4.71	9.8	1.08	N.A.	N.A.
First Internet Bancorp (INBK)	4.10	-2.5	1.00	54.15	2.59
MVB Financial Corp. (MVBF)	2.98	9.1	0.95	89.98	3.45
Coastal Financial Corp. (CCB)	2.97	48.0	1.17	59.08	4.46
Medallion Financial Corp. (MFIN)	2.11	21.4	3.35	41.86	8.67
Provident Bancorp Inc. (PVBC)	1.79	12.8	1.16	59.18	4.23
FinWise Bancorp. (FINW)	0.37	27.0	9.02	38.87	15.31
Group median	11.3	1.22	54.15	4.23	

Data compiled Oct. 26, 2022.

ROAA = return on average assets; NIM = net interest margin; N.A. = not available.

Analysis includes select U.S. public financial institutions, which themselves or through their subsidiaries, offer banking-as-a-service products.

Data based on GAAP filings.

Source: S&P Global Market Intelligence.

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Higher than the aggregate industry ROAA of 1.08% as of June 30

Lower than the aggregate industry efficiency ratio of 58.7% as of June 30

Accounting Complexities – FinTech Fund Investments

- Nature of investee- i.e., SBIC, VC fund, L.P.
- Level of ownership and control
 - VIE considerations first – then Voting Interest model next, if not a VIE
 - SEC guidance for LP (similar guidance is included in the call report instructions glossary)

The SEC staff's position on the application of the equity method to investments in limited partnerships ... requires the use of the equity method unless the investor's interest "is so minor that the limited partner may have virtually no influence over partnership operating and financial policies." The SEC staff understands that practice generally has viewed investments of more than 3 to 5 percent to be more than minor.

- Don't focus only on the %, think about other indicators of significant influence or control
- Equity investments – fair value or measurement alternative
- Equity method investments – FVO or record % of income/ loss and analyze for impairment
- Consolidation

FinTech Fund Investments: Case Study

Fact Pattern: In 20X2, BankOne commits to making \$5 million investment in FinTech focused SBIC fund that is established as limited partnership. The fund is expected to raise \$250 million. In 20X3, BankOne funds its \$5 million investment. The fund overall raised \$200 million.

Accounting Questions:

- How should the commitment be accounted for or disclosed?
 - Consider guidance in ASC 440 – may only need to disclose until investment is funded
- What is the accounting when the investment is made?
 - Apply ASC 321 – equity investment in a L.P. with a 2.5% ownership stake
- What is the ongoing accounting?
 - May elect the measurement alternative if deemed not to have a ‘readily determinable fair value’
 - Cost – impairment +/- observable price changes in orderly transactions for the identical or similar investment
 - Determination of “observable”, “orderly”, and “similar” can require judgment

Accounting Complexities – FinTech Direct Investments

- Nature of investee- i.e., corporation, partnership, LLC
- Nature of investment – i.e., common, preferred, warrants, convertible notes
 - Don't rely on the title – additional analysis may be required
- Level of ownership and control
 - VIE considerations first- then Voting Interest model next, if not a VIE
 - SEC/ regulator guidance for LP
 - Other investments
 - Don't focus only on the %, think about other indicators of significant influence or control
- Equity investments – fair value or measurement alternative
- Equity method investments – FVO or record % of income/ loss and analyze for impairment
- Consolidation
- Look at conversion features, embedded features and extraneous instruments that may be included

FinTech Direct Investments: Case Study

Fact Pattern: Bank A has 25% ownership stake in FinTech LLC that is accounted for as an equity method investment under ASC 323. Additionally, the Bank has a \$2 million convertible note at 10% to FinTech LLC that is being accounted for as a debt security under ASC 320. The LLC is converting to C-Corp and raising additional capital. As a result of the conversion, Bank A's LLC common shares will convert to C-Corp preferred shares and Bank A's convertible note will be converted to preferred shares.

Accounting Questions:

- How to account for conversion of the 25% stake in the LLC common shares to preferred shares
 - Are the preferred shares in-substance common stock?
 - If no: ASC 321 – fair value or measurement alternative
 - If yes: step through VIE/VI considerations to assess whether to consolidate or continue EMI treatment
- How to account for the conversion of the convertible note to preferred shares
 - Same questions as above – if the preferred shares are deemed to be in-substance common stock, would consider jointly when assessing VIE/VI considerations
- What is ongoing accounting for the preferred shares?

Accounting Complexities – BaaS

- Revenue recognition
 - Identify contracts with your customer – may have more than 1 customer!
 - What portion of the contracts are within the scope of ASC 606?
 - ASC 606 considerations
 - What about the non-ASC 606 items?
- Lending
 - Who is your customer – the FinTech or the individual customer?
 - Legal lending limit issues
 - Appropriate call report classification
 - Interest-sharing arrangements
 - Presentation considerations
 - Credit enhancement/indemnification of fraud and credit losses – freestanding or embedded?
 - Freestanding – cannot contemplate in the ALLL/determination of charge-off
 - Embedded – follow guidance in ASC 326-20-31-12 (even if not yet adopted ASC 326)

BaaS: Case Study

Fact Pattern: Bank is the lender of record for loans that are sourced and serviced by a FinTech partner. The loan agreement with the customer sets an interest rate of 18% and has other standard lending terms and conditions. The agreement between the Bank and the FinTech partner provides that the Bank's share of the interest will be capped at 5% of the average outstanding balance of the loans, and in return, the FinTech partner will reimburse the Bank for all fraud and credit losses.

Accounting Questions:

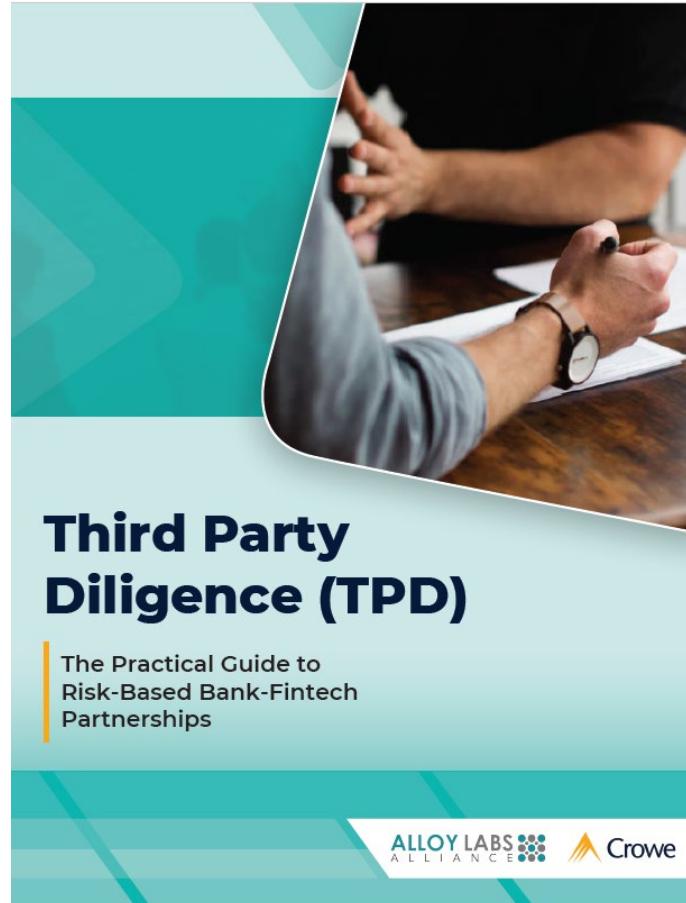
- What is the accounting for the customer contract?
 - May be the same as other consumer loans originated by the bank
- What is the accounting for the FinTech partner contract?
 - Any part in scope of ASC 606? Services provided by FinTech to Bank
 - Sourcing (i.e., loan origination costs)
 - Servicing
 - Credit enhancement
- What is the accounting for reimbursements of credit and fraud losses provided under the credit enhancement?

Regulatory Guidance and Additional Resources



<https://www.federalreserve.gov/publications/files/conducting-due-diligence-on-financial-technology-firms-202108.pdf>

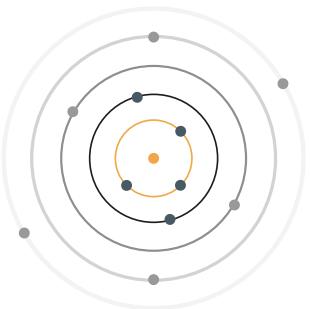
<https://www.federalreserve.gov/publications/files/community-bank-access-to-innovation-through-partnerships-202109.pdf>



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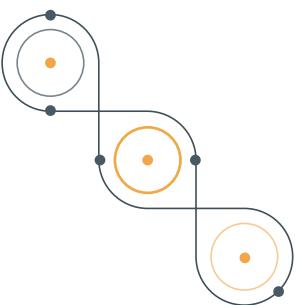
Tips for enabling risk management within FinTech partnerships.

01



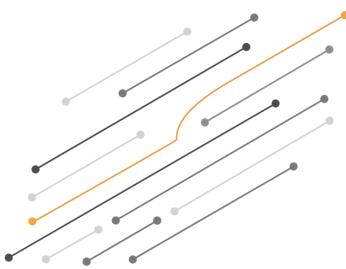
Strategy alignment
and complementary
objectives

02



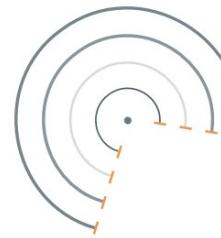
Cultural alignment
and transparency

03



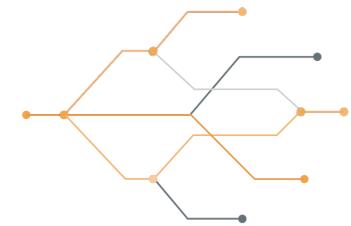
Operational
resilience, capacity
and compatibility

04



Embedded risk
management and
compliance

05



Agree to a plan
that's not
'check the box'

Investments in Tax Credits

Investments in Tax Credits

Historic
Rehabilitation

New Markets

Low Income
Housing

Renewable
Energy

Investment in Tax Credits (ITC)

- Investments are generally accounted for under the equity method of accounting
 - Need to evaluate if equity method is appropriate based on ownership and level of influence.
 - If equity method is applied, book ownership percentage of income/loss against investment.
 - Subsequently evaluate equity method for impairment.
- ITC Method of Accounting - once chosen, should be consistently applied for all similar investments.
 - Deferral Method –
 - ✓ Records the credit against the investment asset over the GAAP depreciable life (Dr. Inc Tax Payable, Cr. Investment); results in less income statement volatility
 - Flow-through Method –
 - ✓ Records the tax credit benefit directly to tax expense in the year generated (Dr. Inc Tax Payable, Cr. Tax Expense)

Investments in Tax Credits

Deferral Method

This example assumes a \$2M tax equity investment

GAAP Investment Account	2021	2022	2023	2024	2025	2026
Beginning Balance	-	250,582	208,571	166,400	124,294	76,472
Contributions	2,000,000	-	-	-	-	-
ITC Offset	(1,739,130)	-	-	-	-	-
Cash Distributions	(10,288)	(42,011)	(42,171)	(42,106)	(47,822)	(163,048)
Distributions Recognized at Income						86,576
Ending Balance	250,582	208,571	166,400	124,294	76,472	-
<hr/>						
Balance Sheet (Deferral Method)	2021	2022	2023	2024	2025	2026
Cash	(1,989,712)	(1,947,701)	(1,905,530)	(1,863,424)	(1,815,602)	(1,652,554)
Investment in Solar Project LLC	250,582	208,571	166,400	124,294	76,472	-
Income Tax Benefits - Investment Tax Credit	1,739,130	1,739,130	1,739,130	1,739,130	1,739,130	1,739,130
Income Tax Benefits - Flow Through Income	351,560	298,611	255,721	213,700	171,101	164,428
Deferred Tax Assets	-	-	-	5,430	11,508	-
Total Assets	351,560	298,611	255,721	219,130	182,609	251,004
Deferred Tax Liability	22,864	6,437	68	-	-	-
Total Liabilities	22,864	6,437	68	-	-	-
Cumulative Earnings	328,696	292,174	255,653	219,130	182,609	251,004
Total Liabilities and Equity	351,560	298,611	255,721	219,130	182,609	251,004

Investments in Tax Credits

Flow-through Method

This example assumes a \$2M tax equity investment

GAAP Investment Account	2021	2022	2023	2024	2025	2026
Beginning Balance	-	1,831,609	1,789,598	1,747,427	1,705,321	1,657,499
Contributions	2,000,000	-	-	-	-	-
Contra- Contributions	(158,103)	-	-	-	-	-
ITC Offset	-	-	-	-	-	-
Cash Distributions	(10,288)	(42,011)	(42,171)	(42,106)	(47,822)	(163,048)
Gain(Loss) on exit	-	-	-	-	-	(1,494,451)
Distributions recognized as income	-	-	-	-	-	-
Ending Balance	1,831,609	1,789,598	1,747,427	1,705,321	1,657,499	-

Balance Sheet (Flowthrough Method)	2021	2022	2023	2024	2025	2026
Cash	(1,989,712)	(1,947,701)	(1,905,530)	(1,863,424)	(1,815,602)	(1,652,554)
Investment in Solar Project LLC	1,831,609	1,789,598	1,747,427	1,705,321	1,657,499	-
Income Tax Benefits - Investment Tax Credit	1,739,130	1,739,130	1,739,130	1,739,130	1,739,130	1,739,130
Intangible Assets, net	126,482	94,862	63,241	31,621	-	-
Income Tax Benefits - Flow Through Income	351,560	298,611	255,721	213,700	171,101	164,428
Deferred Tax Assets	-	-	-	-	-	-
Total Assets	2,059,069	1,974,500	1,899,989	1,826,348	1,752,128	251,004
Deferred Tax Liability	354,880	338,453	332,084	326,585	320,508	-
Total Liabilities	354,880	338,453	332,084	326,585	320,508	-
Cumulative Earnings	1,704,189	1,636,047	1,567,905	1,499,763	1,431,620	251,004
Total Liabilities and Equity	2,059,069	1,974,500	1,899,989	1,826,348	1,752,128	251,004

Investments in Tax Credits

Low Income Housing Tax Credits (LIHTC)

- Option to elect Proportional Amortization Method (PAM) for qualified investments
 - If elected, must be applied to all investments that qualify for the use of PAM (i.e., cannot pick and choose)
 - Under this method, the investment is amortized in proportion to the tax credits and benefits allocated to the bank and the amortization expense is recognized in the income tax expense line item.
 - ✓ Practical Expedient: Can amortize the investment in proportion to only the tax credits allocated if you expect that doing so will produce a relatively similar outcome as amortizing in proportion to the tax credits and benefits.
 - Proportional amortization method is limited to investments in LIHTC.



Amendment would apply to all reporting entities that meet the conditions for and elect to use proportional amortization method to account for tax equity investments.

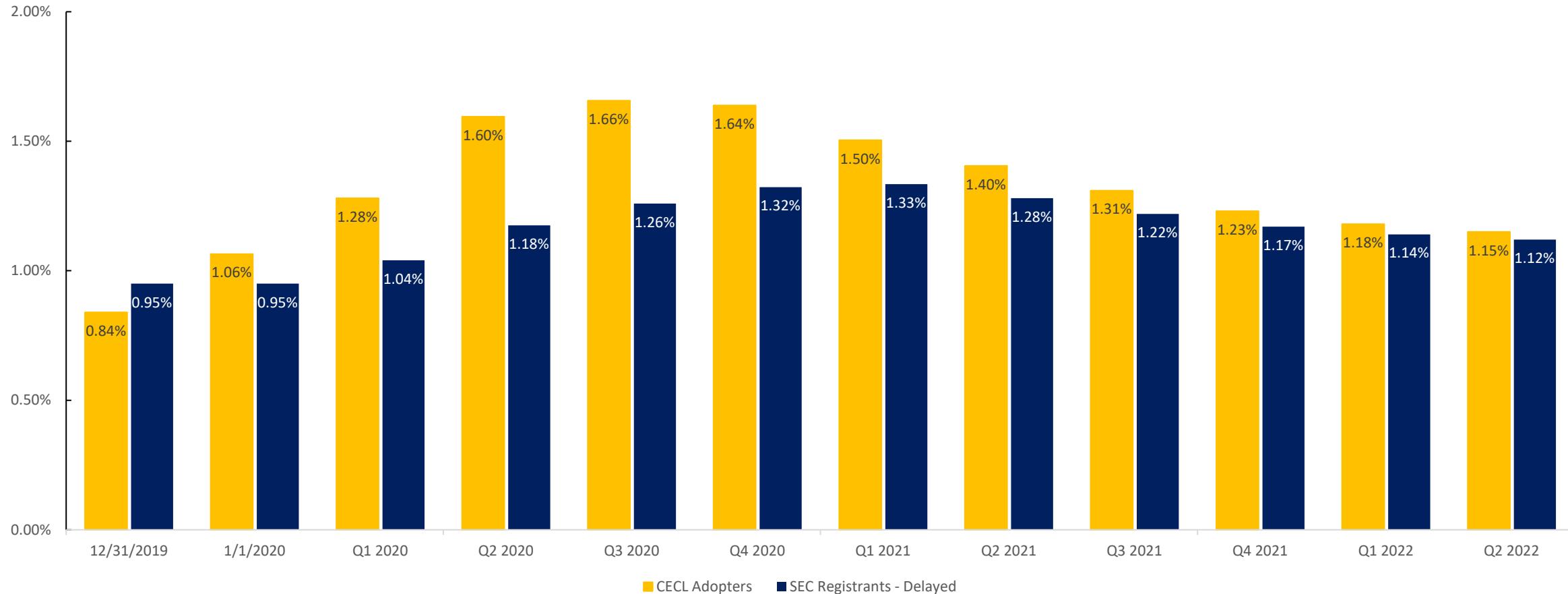
Renewable Energy Credits

- The structure of these ITCs are much more complex.
- Accounting model applied is hypothetical liquidation book value (HLBV) which is complex and time intensive.

CECL Practice Observations

Allowance Comparisons: CECL Adopters vs. Non-Adopters

Median Allowance to Loans Ratios



2023 CECL Reminders

Those Who Have Already Adopted

- Evaluate key drivers, assumptions and qualitative factors to ensure updated with relevant information
- ASU 2022-02 accounting and disclosure changes

2023 Adopters

- Don't forget the forecast!
- Key loss drivers
- Disclosure considerations
- Model validation
- Control framework
- Changes due to ASU 2022-02



2023 CECL Reminders – All Institutions

Qualitative Factor Framework Observations

- Focus assessment of qualitative factors on those unidentified risks not captured in the quantitative calculation – don't necessarily need to equally weight or allocate anything for those factors already captured in the math
- Reduce the subjectivity in developing qualitative factors – consider using alternative forecast scenarios or high watermarks in loss history to anchor
- Don't double count!

Economic conditions / scenario updates

- What economic factors do you use? Should they change?
- Consider weighting scenarios to apply the adjustment quantitatively, but support with documentation

Model Validations

- SOC and model validation are complementary not duplicative
- Any changes to assumptions or key calculation drivers should go through model validation
- Work with the risk department to determine how often validations should occur

Sensitivities

- When evaluating changes to the model or drivers, run sensitivities to understand the overall impact

M&A considerations

- Reminder to understand differences if acquirer and acquiree use different allowance methods or models

Risk Considerations



Risk Considerations

- IT Workflows / User Access Considerations
- Increased Fraud Risk
 - Commission-based roles
 - Economic pressures



Thank you

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